



OFFICE OF THE
ARIZONA STATE TREASURER

HON. DEAN MARTIN
TREASURER



October 9, 2009

The Honorable Jan Brewer
Governor
State of Arizona

Dear Governor Brewer

As requested, attached are potential budget solutions to assist the state general fund by reducing our expenses in excess of 15% in FY 2010. The general fund appropriation to the State Treasurer's office is currently 57% of our 1991 budget, from \$6.3 million down to \$3.6 million. Our employees have been reduced from 32 (funded, filled positions) in 1991 to 25 this year, even though the amount of money managed by this office has increased by 361% and the amount of deposits have increased by 291%.

Since the beginning of the current state fiscal crisis in FY 2008, our operating budget has been decreased by more than 25 percent. Our Banking Services, Administrative Services, Investment Management and Executive Staff divisions are all down at least one FTE. In total, we believe we are already operating without the 7 FTEs that we consider to be the bare minimum required to properly perform the functions of this office. Reductions in any area of operations would result in unacceptable risk for potential losses of state funds through fraud or neglect as well as opportunity costs in investing tax revenues. In fact, we need two critical positions restored to protect the state from future loss: a credit analyst position and a compliance officer/internal auditor. (Internal auditor funds were provided at our request in FY 2008, but eliminated in the mid-year 2008 budget cuts.)

However, recognizing the ongoing budget pressures facing the state, we can provide more than the 15% savings requested. There is an opportunity for the state general fund to realize up to \$943,956 in FY2010 savings if our proposed solutions are implemented by January 1, 2010 (a reduction of 25.5%). Annualized, this could provide about \$1,788,412 in ongoing general fund savings. These solutions are similar to what we submitted as part of our FY 2011 budget request and would fast-forward these actions to January 1, 2010. It would also provide the 2 additional FTEs to fill the critically needed credit analyst and compliance/internal auditor positions, while still providing a 25.5% general fund savings.

If you or your staff has any questions, feel free to contact myself or either of my two Deputies, Klint Tegland or Mark Swenson, at 602 604-7800.

Sincerely,

Dean Martin
Arizona State Treasurer

CC: Eileen I. Klein, Deputy Chief of Staff, Finance

FY 2010 BUDGET REDUCTIONS - SUMMARY OF ISSUES
Arizona State Treasurer's Office

GENERAL FUND

FY 2010 General Fund Budget 3,607,500

AGENCY REDUCTION TARGET - GENERAL FUND \$541,125

Priority	Issue Title ¹	Reductions Amount
1	Issue 1	\$386,456
2	Issue 2	\$557,500
Issue Total		<u>\$943,956</u>
Fund Total as a Percentage of General Fund Reduction Target		174%

¹ Please complete the attached Description and Impact Statement for each issue.

Please note that as of September 30, all management fees charged by office are to offset the operating budget of the office, thus the only GF funding left is for JP salaries

FY 2010 BUDGET REDUCTIONS - SUMMARY OF ISSUES
Arizona State Treasurer's Office

ALL NON-GENERAL FUNDS

FY 2010 All Non-General Funds Budget (less Federal Funds) 2,580,700

AGENCY REDUCTION TARGET - ALL NON-GENERAL FUNDS (w/o Federal Funds) \$387,105

Fund	Reductions		Percent Reductions
	Amount		
New Payroll Pro-Rate Fund	\$386,456		99.8%

Issue Total \$386,456

All Non-General Funds Total as a Percentage of Agency Non-GF Reduction Target 100%

Please note that as of September 30, all management fees charged by office are to offset the operating budget of the office, thus the only GF funding left is for JP salaries

FY 2010 BUDGET REDUCTIONS - SUMMARY OF ISSUES
Arizona State Treasurer's Office

Treasurer's Management Fund

FY 2010 All Non-General Funds Budget (less Federal Funds) 88,300

AGENCY REDUCTION TARGET - ALL NON-GENERAL FUNDS (w/o Federal Funds) \$13,245

Priority	Issue Title ¹	Reductions Amount
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Issue Total	\$0
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Fund Total as a Percentage of Non-General Fund Reduction Target 0%

¹ Please complete the attached Description and Impact Statement for each issue.

**STATE OF ARIZONA
FY 2010 BUDGET REDUCTIONS - ISSUE DESCRIPTIONS**

Arizona State Treasurer's Office

Issue Title: Payroll Pro-Rata Charge

Issue Priority: 1

Reduction Amounts:

Other Fund: \$436,456

Other Fund: (\$50,000)

Total: \$386,456

Amount: \$386,456

Issue Description and Statement of Effects

Institute a .10% payroll pro rata charge similar to the charges imposed by GITA, the Attorney General and various ADOA functions. The proposed .10% pro rata would be to cover our non-investment banking related services of the office, which we estimate to be about 58% of our operating budget. This would raise an estimated \$1,445,824 annually to cover those operating costs (assuming a 20% reduction in total State of Arizona payroll for FY 2010). Assuming General Fund accounts for approximately 50% of all payroll costs, this would shift \$722,000 of General Fund costs to Other Funds. If implemented by January 1, 2010, this would provide a \$361,500 savings to the GF in FY2010. This is a far more equitable method to allocate expenses incurred by our office to the funds that actually flow through our office. For example, in FY 2008 more than \$38 billion in deposits were received in our office, yet the GF bore the full cost of operating the office.

Starting Sept. 30, 2009, our office will be completely financed off of the management fees charged for assets under management. Any excess fees collected off of the management fees will flow to the General Fund. Under this budget reduction option, the remaining 42% of our operating budget would be funded by the management fees we currently charge; excess fees above the investment operating budget would go the General Fund. Since banking operations would be funded from the pro rata charge, fewer expenses would be charged against the management fees, thus more revenue to the General Fund. This will also allow us to lower management fees slightly to remain competitive and attract more local government investment funds. We note that Mohave County recently moved its investments to a firm that is charging only 5.5 basis points instead of the 6 basis points we are required to charge.

Currently, management fees are not charged to the endowment fund. To do so would require either a change to Article 10, Section 7 of the Arizona Constitution, or a similar statutory change as was recently enacted for the State Land Department in IIB 2014, the FY 2010 Environment BRB. The statutory change is assuming any legal challenges to the Land Department statute are

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dismissed. A net annual savings of approximately \$150,000 would occur if management fees could be charged to the endowment to cover the costs of operating the endowment. If implemented by January 1, 2010, this could provide a \$75,000 saving to the GF in FY 2010. However, whatever management fee charged toward the endowment would have to be directly related to managing the endowment. We could not for example, charge 6 basis points and have any excess collections transfer to the General Fund. Such a provision would violate the Constitution. Going forward, we request expenditure authority to expend any management fees charged to the endowment to operate the endowment. This would allow us to hire an equity portfolio manager as well as a credit analyst for the endowment, focusing on long-term fixed income assets.

Compliance Officer/Internal Auditor

As recommended by GAO, this removes a gap in current AFIS security procedures. This position will be used for daily internal auditing and monitoring compliance with investment policy. With nearly \$10 billion of state and local government funds under active management, this position provides for increased internal controls and financial oversight within the office rather than relying on each division to provide self-inspection. Without funding, needed oversight and compliance of internal procedures will continue to be insufficient. Safety and liquidity of investments are key requirements of the Treasurer and this position will ensure these requirements are fully met. This position was funded and established in our FY08 appropriation. Budget cuts removed funding for the position in FY08-09. (Estimated cost is \$90k including ERE, for a quarter-year cost of \$22,500)

Credit Analyst

The senior credit analyst position will support the portfolio managers by evaluating potential new credit programs to invest in. The new credit programs will generate larger returns while maintaining our safety and liquidity requirements. Without the research, there are several investment opportunities that are simply foregone. The position will provide the state with additional protection against catastrophic credit events, improve risk adjusted returns, identify sectors for adding "alpha" to the portfolio and review and monitor all existing corporate notes and mortgage securities. (Estimated cost is \$110k including ERE, quarter-year costs are \$27,500) With several new SEC rule changes proposed, additional staffing is required to maintain a working knowledge of and monitor the new market standards.

**STATE OF ARIZONA
FY 2010 BUDGET REDUCTIONS - ISSUE DESCRIPTIONS**

Arizona State Treasurer's Office

Issue Title: Eliminate JP Salary Subsidy

Issue Priority: 2

Reduction Amounts:

Other Fund: \$557,550

Total: \$557,550

Amount: \$557,550

Issue Description and Statement of Effects

A.R.S. 22-117 requires the state to pay 40% of the salary of each Justice of the Peace, with the county paying the remainder. Since FY 2003, session law has reduced this to the state paying 38.5% and in 2007 the law was changed so Maricopa County doesn't receive any subsidy. In the just completed special session, the 38.5% was reduced to 19.25%. This option would eliminate the entire subsidy starting January 1, 2010 to save the GF \$557,550 in FY2010 and \$1,115,100 on an annual basis. .

Elimination of this program will allow our office to redeploy an estimated .05 FTE work to the administrative services division.

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